

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBERS: 03-0114, 03-0115, 03-0130
Gross Income Tax
For the Years 1999, 2000, 2001

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ISSUE

I. Gross Income Tax-Imposition

Authority: IC 6-8.1-5-1(b), IC 6-2.1-2-2, 45 IAC 1.1-6-2, *First National Leasing and Financial Corp. v. Indiana Department of Revenue*, 598 N.E.2d 640, (Ind. Tax 1992).

The taxpayer protests the imposition of gross income tax on income from certain leases.

STATEMENT OF FACTS

Taxpayer is a business engaged in the leasing of computer hardware and other technological equipment. Taxpayer's offices are located in another state, and Taxpayer does not maintain an office or personnel in Indiana. The property that Taxpayer leases is subject to a security interest in the state in which it is located and notification in the event it is moved to another state; however, Taxpayer does not control the location of the property with very minor exceptions. As a result of Department audit, Taxpayer was assessed gross income tax with respect to its income from leases located in Indiana. Taxpayer protested the assessment, and this Letter of Findings results.

I. Gross Income Tax-Imposition

DISCUSSION

All tax assessments are presumed to be accurate and taxpayers bear the burden of proving that any assessment is incorrect. IC 6-8.1-5-1(b).

Indiana imposes a gross income tax on the "taxable gross income derived from activities or businesses or any other sources within Indiana" of a nonresident taxpayer. IC 6-2.1-2-2. The Department assessed gross income tax on the taxpayer's income from leases of computers and technological equipment in Indiana. Taxpayer contended that its lease income was not derived

from an Indiana source and therefore not subject to the Indiana gross income tax. The issue to be determined in this case is whether Taxpayer's lease income was actually derived from an Indiana source and was therefore subject to the Indiana gross income tax.

The gross income tax law concerning the taxability of income from intangibles such as the taxpayer's leases is clarified at 45 IAC 1.1-6-2 as follows:

- (b) Except as provided in subsection (c), receipts derived from an intangible are included in gross income.
- (c) Receipts derived from an intangible are not included in gross income under the following situations:
 - (1) The intangible forms an integral part of:
 - (A) a trade or business situated and regularly carried on at a business situs outside Indiana; or
 - (B) activities incident to such trade or business.
 - (2) The intangible does not form an integral part of a trade or business situated and regularly carried on at a business situs in Indiana, and the taxpayer's commercial domicile is located outside of Indiana.
 - (3) The receipts from the intangible are otherwise excluded from gross income under IC 6-2.1-1-2 or 45 IAC 1.1-3-3(c)(7).
- (d) In determining whether an intangible forms an integral part of a trade or business or activities incident thereto under subsection (c) it is the connection of the intangible itself to such trade or business or activities incident thereto that is the controlling factor. The physical location of the evidence of the intangible (share of stock, bond, etc.) is not a controlling factor. Also, any activities related to the sale of an intangible occur after the fact and are never determinative.
- (e) As used in this section, "commercial domicile" means the nerve center of the taxpayer where a majority of the activities and functions of the business are performed. The department will include the following types of activities in making a determination of commercial domicile.
 - (1) The location of management and administrative activities connected with each location, such as policy and investment decisions.
 - (2) The location of meetings of the board of directors.
 - (3) The residence of executives and their offices.
 - (4) The location of books and records.
 - (5) The location of payment on income from intangibles of the taxpayer.
 - (6) The information from annual and quarterly reports of the taxpayer.

The Indiana Tax Court also dealt with the issue of the gross income taxability of a nonresident taxpayer's receipts from leases in *First National Leasing and Financial Corp. v. Indiana Department of Revenue*, 598 N.E.2d 640, (Ind. Tax 1992). In that case, First National leased equipment to another corporation which used the equipment in its train derailment business. The Court set out a three part inquiry for analyzing whether or not gross income from an intangible is subject to Indiana gross income tax. First the income must be gross income. Secondly the gross income must be derived from sources within Indiana. Finally the gross income that is derived

from sources within Indiana must be subject to the Indiana gross income tax. In the first step of the analysis, the Court determined that First National actually received gross income from the leases of property used in Indiana. The Court next analyzed whether the gross income was derived from activities in Indiana. The leased equipment included several mobile items such as big over-the-road trucks, tractors, lowboy trailers, pick-up trucks, cranes, miscellaneous generators, light plants, and caterpillar tractors with side booms for lifting. *Id.* at 642. That equipment was stored and used a portion of the time in Indiana. First National did not have control over the equipment nor did it know where the equipment was actually located at any particular time. All commercial activities such as negotiations and signing of documents related to the lease agreements took place outside Indiana. *Id.* at 645. The Court determined that First National's lease income was derived from sources outside of Indiana. Therefore the income was not subject to the Indiana gross income tax.

Taxpayer concedes that the lease income is gross income within Indiana's gross income tax statute, satisfying the first part of the analysis.

The taxpayer's offices, administrative personnel, administrative services, board of directors, and books and records were all outside of Indiana. The taxpayer's lease income derives from leases that were negotiated, executed, and maintained outside of Indiana.

The taxpayer contends that its lease income was identical to the non taxable income of First National. Taxpayer's argument is persuasive with respect to the property in question. The gross income received from the leases of the property in question is not derived from Indiana activities.

FINDING

The taxpayer's protest to the gross income tax is sustained.